

**FINANCIAL MANAGEMENT IN
HUNGARIAN CITIES:**

**THE CASE OF
PÜSPÖKLADÁNY**

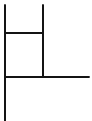
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FINANCIAL MANAGEMENT IN HUNGARIAN CITIES:

THE CASE OF PÜSPÖKLADÁNY

INTRODUCTION

Püspökladány lies at the junction of three major regions called Hortobágy, Nagykunság and Nagysárrét in the middle of Trans-Tisza, the eastern part of Hungary. The city is a typical plain land settlement, built on a ridge of the one-time swamp area of the Great Plain. The first mention of the settlement, Ladan, is in the 1351 charter of the Várad Convent. The compound form, Pispék Ladan, appeared first in 1543; Pispék (bishop) referred to the Várad episcopacy, the feudal owner of the land.

While in the medieval centuries the settlement had been an insignificant one, it became the seat of one of the districts of county Hajdú established in 1876. Since then it has been an economic, transportation, administrative, cultural and health care center of the county, now called Hajdú-Bihar. Püspökladány was ranked a city January 1, 1986. Its current population is 17,033. Table 1, shows that Püspökladány is the smallest community in our study, both in terms of population and budget.

Table 1
Population and budget of six cities

	Szentes	Orosháza	Tatabánya	Nagyka-	Szolnok	Püspök-
Population	31,612	32,944	72,207	52,574	78,511	17,033
Total of the 1998 Budget	2,949,261	4,239,395	6,786,435	6,846,386	9,605,714	1,268,746
Total per Capita Budget	93.3	128.7	93.9	130.2	122.3	77.4

Economy

For a long time, the main economic activity in Püspökladány was agriculture. However, recently the labor structure of the city has changed significantly. Formerly the major employers in the city had been local agricultural state cooperatives, the Hungarian Railways (MÁV) and the timber industry. Due to the economic transformation, both MÁV and the timber industry reduced their capacity and agricultural coops were broken down to smaller sectoral units. In recent years some small cloth-making shops have been established employing local labor force for minimum wages as there is an oversupply of labor from the local dress-making



school.

Currently 52 percent of the active population work in the construction and other industries or in transportation and commerce, 27 percent in agriculture and 21 percent in other sectors. There are 1120 unemployed (6.5 percent). There is a large number of families needing regular welfare aid. The proportion of Gypsies is 8 percent, many of them unemployed.

Currently the city's economy is made up of business organizations, enterprises, traditional and modernized plants as well as service providing units. However, capital attraction, affected by traditions, culture, infrastructure and transportation, is very low in the region. There is a lack of a well qualified industrial work force: earlier industry produced for the eastern market here using masses of unskilled labor. New businesses are very conservative, not innovative enough, unable to grow, and pay very low wages. Consequently, there is a high number of people in need of welfare and local tax capacity is very low.

Infrastructure

Basic utilities are fairly good in the city: water and electricity coverage is almost full, 90 percent of the city has piped gas, 68 percent has hard cover roads, and 70 percent has telephone service. The only serious problem is sewage, which services as little as 26 percent of the city (see Table 2). In comparison with the other cities in our research, hard cover roads are scarce.

Table 2
Infrastructure in the six cities



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1996	Szentes	Orosháza	Tatabánya	Nagy- kanizsa	Szolnok	Püspök- ladány
Meters of sewage per km of water pipe	427	148	448	711	738	327
Percent of housing units hooked up to water mains	92,9	79,3	96,4	98,5	97,8	94,2
Percent of housing units hooked up to sewage	33	32,4	81,8	76,2	76,3	26
Percent of hard cover roads	81	60	94	87	75	67



Tourism

In the city there is a medical thermal bath credited with curative properties. The wooden bridge St. Agatha over the Berettyó river is a rare spectacle. The 70-year old botanical garden in the Farkassziget forest is a formidable natural sight, where research on reforestation on sodic soil began in 1924.

CITY POLICY AND STRATEGY

Although Püspökladány has no specific written community strategy or policy document, the goals and vision that the city has set for itself can be understood through interviews, as well as the ways it can achieve them. The strategic goal of the city is that “Püspökladány wishes to be a city, which would be the regional center of education, culture, transportation and economy.” City here is not only an administrative term but also involves a special spirit and attitude; in our view, eastern regions lag considerably behind the western part of Hungary in this respect.

This strategic goal is being pursued through the set of municipal services, investments and regional cooperation efforts.

Municipal Services

Besides mandatory municipal services required by the Local Government Act, the city provides non-mandatory services too, such as secondary education, public cleanliness, bath operation as well as supporting culture and sports. (Mandatory and non-mandatory services are listed in Appendix 1.) However, the law does not provide a clear cut division between mandatory and no-mandatory services. It is especially true for city management: even though they are not mandatory services, no municipality can do without channeling storm water or public sanitation or operating a landfill. Accordingly, non-mandatory services can be put into two categories:

Services which the municipality has no choice in providing: these services are expected by citizens² because everyone is affected, or impact the conditions in the city (for

² Often restructuring old institution systems or canceling services faces serious opposition from citizens because they simply had got used to them and expect the local government to continue the provision.



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example, public cleanliness).



Services which the municipality may choose to provide or not: the city must provide only some of them, while possibly choosing not to provide other ones (operating and maintaining swimming pools, libraries, sports halls and museums are among this type of service that the city is currently providing)³.

The goals of the city and the profile it wishes to attain are reflected in its choices of which non-mandatory services to provide. For instance, that the city supports sports and culture can be seen in Table 3 (from the list in the category “other sectors”). The city does so by trying not to “waste” what it had inherited from the former regime (library, sports field, sports hall, bath) and base the development of the city on them. Even more important for the municipality is education. Table 3 shows that 21 percent of expenditures is spent on the 24 items in the category “other services” while 54 percent is spent on education alone. Of the 54 percent less than half (21.5 percent) is spent on primary education (a mandatory service) while the rest is spent on secondary education, musical and fine arts education, all voluntarily provided by the municipality. Non-mandatory education services represent a large volume in expenditures, and the municipality, troubled with serious operational problems, could transfer secondary education to the county (as was done by several municipalities). Yet, municipal leaders believe retaining secondary schools for itself helps Püspökladány to keep its rank of a city. Officials believe that the city pays much more attention to education and assumes greater responsibility than the county would do, citing a previous bad experience in which once the city transferred an elderly home to the county only to have the county close it down.

That education is a priority area for the city is evidenced in that it provides a wide range of services: education for mildly mentally disabled children, basic arts education, special physical education; and a special emphasis on language and computer science. The six-grade secondary education program, launched in 1992, provides special education for talented children, and has proven very successful⁴.

The third large group of services is social services. In this sector an ever increasing number of services and scope of authority are delegated to the local level. Separating what services are mandatory and non-mandatory is even more difficult as the Local Government Act only says that the provision of social services is mandatory (but does not identify specific services) while the Social Act defines services to be provided and identifies mandatory and non-mandatory services. Those interviewed remarked that those eligible for various welfare supports know all too well what they are entitled to and “force” the local

³ These services generally affect fewer groups of society.

⁴ In recent years, six-grade secondary schools have become very popular all over the country, preparing pupils much better than traditional secondary schools for the secondary final examination as well as for higher education.



government to give.

Therefore, **local government staff feel** there is no sense in **differentiating between** mandatory services **and from** non-mandatory ones as any discretionary welfare payment becomes (quasi) mandatory under pressure from people.

~~Appendix 2 groups mandatory welfare provisions by form of financing (see in more detail in the section on normative transfers).~~

Besides welfare supports, social services include services provided by institutions. Here the municipality enjoys greater flexibility. Social institutions (nursery school, regional elderly center, clinic, social service center) and the non-mandatory services they provide are an evidence that the city is sensitive to health care and social problems.

Below, Table 3 lists all services provided by Püspökladány, and the share of operational expenditures each represents. The following observations of particular interest, further illustrated by Table 3, can be made regarding service delivery:

Summary

Municipal services in Püspökladány are grouped in four categories: city management, social services, education and other services⁵.

Inherited institution systems and citizen expectations play a great role in determining what services the city provides.

Education is a priority area in Püspökladány since the municipality believes that through good quality education a better labor force can be developed in order to improve the city's economic chances.

The municipality supports earlier neglected facilities that may improve tourism and ensure a unique feature for the city.

Table 3
Shares of various municipal services in operation expenditures (1998 estimates)

⁵ The operation of the Mayor's Office features in the "other services" category, though in our opinion it should be a separate category.



	Total Cost	A percentage of operational expenditures
SERVICES RELATED TO CITY MANAGEMENT		
—Local government auxiliary service	2,180	0.19
—Community scheme jobs at the local level	23,201	2.01
—Public lighting	15,111	1.31
—Operating welfare facilities	850	0.07
—Advertisement costs of geodesy	1,000	0.09
—Precipitation water drainage	4,000	0.35
—Other services	1,862	0.16
—Fees for experts and lawyers	2,447	0.21
—Cattle administration	1,300	0.11
—Real estate development	1,796	0.16
—Services related to city management	29,639	2.56
TOTAL	83,386	7.21
SOCIAL PROVISIONS		
—Nursery school	5,525	0.48
—Regional elderly center	19,443	1.68
—Family doctors	1,447	0.13
—Clinic	82,353	7.12
—Medical night service	11,414	0.99
—Social provisions (aid payments)	76,524	6.61
—Sárrét Social Service Center	7,335	0.63
TOTAL	204,041	17.63
EDUCATION		
—Top institution of kindergarten	131,560	11.37
<i>Primary School Education</i>		
—Sándor Petőfi primary school	124,904	10.79
—Primary school on Kálvin Sq.	86,666	7.49
—Primary school in Petritelep	37,232	3.22
<i>Primary School Education Total</i>	248,802	21.50
<i>Secondary Education</i>		
— Ferenc Karacs high school and textile industrial vocational secondary school	120,030	10.37
—Pál Petri vocational training school	93,168	8.05



	Total Cost	A percentage of operational expenditures
<i>Secondary Education Total</i>	213,198	18.43
—Music and arts school	32,464	2.81
—Experts' fees in the pedagogical program	500	0.04
EDUCATION TOTAL	626,524	54.15
OTHER SECTORS		
—Operation of the culture hall	12,109	1.05
—Support for the Education Foundation	500	0.04
—Support for the Sports Foundation	4,500	0.39
—Support for Associations	1,000	0.09
—Support for Ethnic Councils	500	0.04
—Mayor's Office	97,110	8.39
—Operation of the City Council (Twin City)	15,824	1.37
—Library	8,476	0.73
—Operation of the holiday camp at Balatongyörök	2,108	0.18
—Operation of the Sports Hall	2,400	0.21
—Support for newspaper Ladányi News	1,500	0.13
—Civil defense	1,696	0.15
— Education Counseling. Operation of the Enterprise Promotion Foundation	670	0.06
—Maintaining the sports field	1,884	0.16
—Maintaining the museum	400	0.03
—Other financial transactions	2,400	0.21
—Operation of the fire department	73,540	6.36
—Paying VAT	3,977	0.34
—Local jubilee bonuses	8,961	0.77
—Support for churches	700	0.06
—Costs paid and bills passed on	1,100	0.10
—Bonuses for institution heads	1,466	0.13
—City events	200	0.02
—Mobile police office	100	0.01
OTHER SECTORS TOTAL	243,121	21.01
OPERATION COSTS TOTAL	1,157,072	100.00



Investments

In the period from 1995 to 1997 Püspökladány pursued a scaled down investment policy. The three biggest investments were a 9 unit social rental housing construction program (HUF 15.7 million), improvements in the bath (HUF 14 million) and the construction of a main sewage pipe (HUF 24.8 million)⁶.

Social housing was built from privatization revenues on the periphery of the city. A couple of disadvantaged families were moved here, their former building was demolished and a shopping center, better suited to the down town cityscape, was constructed on the land.

Improvements in the bath were done because the bath is part of the city's profile, a potential attraction for tourists, as well as a natural resource to be used to the advantage of the city.

As for the infrastructure, the city is underdeveloped in terms of sewage. What it has in pipelines is bad, needing repair and improvement. Sewage investments begun in 1997 have continued in 1998 as a priority activity.

The city wishes to strengthen its status as a "transportation center" by actively supporting and devoting resources to the re-qualification of road 4 going through the city as a highway⁷.

Regional Cooperation

Püspökladány is a member of a sub-regional association (here statistical region and natural region are more or less identical) made up of 14 municipalities. The association's regional development concept covers the following areas:

- Transportation
- Employment
- Agricultural production

⁶ Investment projects implemented in this period are listed in Appendix 3.

⁷ A feasibility study on Highway 4 is being prepared in cooperation with two other counties (Pest and Jász-Nagykun-Szolnok). The County Regional Development Council granted Püspökladány, the municipality holding responsibility, HUF 4,200,000 to prepare the study. Necessary own resources, HUF 1,800,000, are ensured by three local governments (county Hajdú-Bihar and Berettyóújfalu and Püspökladány). The cost of the study for the county is HUF 6 million while for the municipality HUF 600,000.



- Alleviating social problems
- Environmental protection

In these areas the following regional investments have been, or are being implemented:

- C Modernizing road 42 and qualifying road 4 as a highway (a central investment also mobilizing local resources).
- C Constructing a new food processing plant next to the Kaba sugar refinery (business resources).
- C Setting up a social provisions and family center institution with Püspökladány as its headquarters (central grants and local resources).
- C Preparations for constructing a landfill from central grants and local resources.

According to the mayor, further regional problems to be solved are waste water treatment and social problems. In his opinion high unemployment could be most efficiently addressed in a region-wide effort. On the one hand new jobs should be created and on the other hand the training of the work force is necessary in order to better respond to market requirements (computer and management skills, knowledge of languages as well as of customs and tax regulations). Also in the area of agricultural processing, a region-wide cooperation seems necessary.

The mayor of Püspökladány represents the region in the County Regional Development Council. The CRPC has prepared a county-wide regional development concept that served as the basis for the sub-regional concept which in turn was the basis for the city development concept. These concepts are coordinated with each other and are designed both from the top down and bottom up. A more specific and program-like formulation of the concept is a regional development program, which is currently being prepared, and is to be financed by the Regional Development Council. According to the program, Püspökladány should be strengthened as a regional center, primarily in terms of education, culture, health care and transportation. The city plans to involve central, municipal and business resources (but not loans which it wishes to save for sewage and waste water treatment plant improvements).

C FINANCIAL MANAGEMENT

Püspökladány relies on central resources and is loath to borrow and to collect local taxes. The main objective of the municipality is to create necessary resources to finance mandatory and non-mandatory services without overburdening citizens and taking political risks that are too great. However, shrinking central resources, the fact that they have spent privatization revenues, and the appearance of new



mandatory services involving extra costs (primarily in the social sector) raises the question of whether it is the right policy to pursue. Financial constraints are directing the municipality to seek new possibilities and solutions. It seems that a reasonable local tax, the rationalizing of institutions as well as taking related political risks are almost inevitable.

In the next section of the case study we will present how institutions are financed (which means providing services) in the city, what the local revenue policy of the local government is, how it manages its assets, and what the recent innovations in this area are.

C *Financing Services and Institutions*

As in Municipal Services, we examine services by groups (sectors):

- Sector I: City management
- Sector II: Social services
- Sector III: Education
- Sector IV: Other services

The city first of all covers service provision from central normative transfers and reimbursed Personal Income Tax (PIT); the rest has to be financed from “other own resources” (or if PIT is not regarded as own resource than from “own resources”).

In 1998, financing resources of various sectors is as follows:

Table 3
Sector Resources in 1998—(HUF thousand)

Sector	Total Municipal Financial Need	Normative Transfers (in percent) ⁸	Other Required Resources PIT + Own Resources
City management	66,062	20,440 (31)	45,622
Social services	106,456	34,114 (32)	72,342
Education	554,184	393,434 (71)	160,750
Other services	235,923	106,661 (45)	129,262
Total	962,625	551,649 (57)	410,976

PIT revenues are broken down as follows:
share estimates for 1998

- 20 percent of PIT (standard amount reimbursed to the locality 2 years after original payment) 93-,799
- PIT supplement (redistributed to local governments below the national average in PIT) 113-,516
- PIT share for social and child benefit services (based on social needs) 85-,765
- 4- Total PIT 293-,080
- Total PIT Available in sectors I, III and IV.⁹ (total PIT minus the share for social services) 207-,315

Table 4 shows that in Püspökladány 57 percent of operation costs are covered by normative transfers. The actual share of normative transfers in operation costs is even higher than that as the part of the PIT reimbursement that the city receives for social and child welfare services is in fact a social normative transfer. The total of central social normatives, i.e., regular transfers plus earmarked PIT (HUF 34,114 thousand + HUF 85,765 thousand = HUF 119,879 thousand), is more than the required subsidy in the social sector. Therefore the city may channel resources to other areas.

In Püspökladány, just as in the rest of the communities in our research, the share of normative transfers is the highest in the education sector.

PIT and PIT supplement cover 50 percent (HUF 207,315 thousand) of other required resources. The other 50 percent has to be covered from own resources.

Table 4
Share of own Resources in Operation costs for 1998

⁸ Figures in parentheses show what percent of total resource requirements are covered from normative transfers.

⁹ The share of PIT for social services is deducted from total PIT



Other Required Resources:	410,976
PIT	207,315
Own Resources	203,661



Total Local Revenues (Including Local Taxes)	249,115
Local Taxes	43,500
Own Resources Requirement/Total Local Revenues (in percent)	81
Own Resources Requirement/Total Local Revenues–Local Taxes (in percent)	99

Table 5 shows that 81 percent of own revenues has to be spent on providing services. **Local government staff feel that this is a very high percentage and is still higher, 99 percent, if local taxes are deducted as Hungarian local governments usually do not spend local taxes on operation (this is what local governments promise to tax payers). Like other Hungarian local governments, Püspökladány officials would like to assure local taxpayers that business tax revenues will be spent on investments rather than on operations.** Local taxes added or not, the figure shows that without acquiring supplementary resources the local government may get in trouble in its operations.

— Services Related to City Management

The greatest number of non-mandatory services is in this sector, for any self-respecting local government must maintain proper “public conditions”. Appendix 1 shows that some of the services are provided by the mayor’s office itself, other ones by an Ltd. in municipal ownership. The City and Assets Management Ltd. takes care of park maintenance, public cleanliness, roads and sidewalks, district heating as well as responsibilities related to residential and commercial units, i.e., the major part of communal responsibilities. The municipality provides support for the Ltd. Municipal support is reduced by profits earned. Profits come from:

- Use of non-residential units
- Cemetery maintenance
- Market place management

Following is municipal support for the various city and asset management activities in 1997 and 1998:



Table 5
Municipal support for city management activities (HUF thousand)

Activity	1997	1998
Housing management	800	1,000
Management of non-residential units	-5,020	-3,683
Managing the bus terminal	400	550
Park maintenance	7,690	8,688
Care for grassy areas	1,670	2,038
Road maintenance	5,230	5,280
Road anti-freeze	4,150	3,856
Public cleanliness	2,900	3,346
Land fill	4,840	3,964
Management of the cemetery	—	-1,140
Market place management	-2,070	-2,150
Thermal bath management	3,110	5,890 ¹⁰
Management of the city sports field	1,200	1,884
Total	24,900	29,523

Table 6 shows that some cross-financing occurs between profitable and subsidized activities. The municipality provides less support by the amount of revenues from non-residential units, market and cemetery.

Healthy drinking water supply, a mandatory service, is provided by another Ltd. fully in municipal ownership. As with the City and Assets Management Ltd., here too, the municipality thinks that providing services through a business is more efficient and better regulated. The Water Management Ltd. is responsible for the water supply and sewage structures and services but does not own the assets. The Ltd. operates from fee revenues and at a very small profit. Service fees are set by the local legislative body.

— **Social Services**

Part of the social services (entitled social provisions, in fact welfare payments) are provided by the mayor's office itself. Types and financing of these payments are presented in Appendix 2. They are mandatory services and there are more of them every year. By looking at what new services have been added to municipal operations, it can be seen that

¹⁰ Demand for financing for the bath has considerably increased which may be a consequence of the improvements in the bath carried out in 1997.



now the overwhelming majority is welfare payments (see table 7).

Finances for the new services delegated to the local level, however, are not adequately ensured. Even though some central resources are provided, the municipality has to ensure own resources too¹¹—ever increasing amounts as the number of services increases. For the majority of local governments, this is a big drain on their budgets. Interestingly enough, in Püspökladány the total of social transfers is larger than needed—probably because the city gets a large percentage of PIT reimbursement earmarked for social services.

Financing of the various payments (the same categories are used as in Appendix 2):

- © Financing I/A (normative cash benefits) comes fully from central resources, but cannot be estimated in advance as the local government has to pay costs and be reimbursed from the central budget.
- © In group I/B (means tested cash payments) there are payments that are partly financed from own resources (B/1 gets a 25 percent municipal supplement and B/6 30 percent).
- © In group II/A the municipality finances provisions 1 and 2 (housing assistance and extraordinary child protection benefit) 100 percent, while it pays 30 percent of the regular child protection benefit.
- © Provision in II/B are fully financed by the Social Security Fund.

Table 6
New services added in the past five years

¹¹ The city has to provide 25 percent of the income supplement for community scheme workers and 30 percent of the child protection assistance.



Community scheme jobs (for the unemployed)

Hiring experts and lawyers for special jobs

Cattle administration

Social services:

- Advance payment of child care fee
- Support for creating a home
- Regular welfare aid for active age people without a regular job
- Benefit for the elderly
- Heating assistance
- Extraordinary child protection support for minors
- Regular child protection support

Other social services are provided through budget institutions. These are: the nursery school, the Regional Elderly Center, the clinic, the Family Center. The 1998 estimates of expenditures by resources in these institutions are as following:

Table 7
Revenue structure of social institutions (HUF thousand)

Institution	Total Expenditures	Own Revenues	Transfers	Municipal Support (Normative Transfers + PIT)
Nursery School	5,525	325	—	5,200
Regional Elderly Center	19,443	5,030	728	13,685
Clinic	82,353	3,000	79,353	—
Family Center	7,335	—	1,035	6,300

— Education

Of the municipal budget, 92 percent is spent on operations. 54.2 percent of that sum is spent on education in 7 institutions. This volume suggests that the management of this sector is decisive for the whole municipality.

As already discussed (Table 4), in this sector the municipality ensures 30 percent in addition to central transfers. Table 9 presents the percentage of the expenditures covered from central normative transfers in various institutions.

Table 8
Normative subsidies in educational institutions

Name of the institution	Number of pupils (groups per school)	1998 normative	1998 total estimated expenditures	Normative as a percentage of expenditures
Kindergarten	791 (30)	59,470,600	131,560,000	45
Petőfi primary school	1,030 (43)	93,537,700	124,904,000	75
Kálvin Sq. primary school	650 (26)	57,764,000	86,666,000	66.6
Petritelep primary school	280 (12)	23,899,800	37,232,000	64
Karacs High school	665 (24)	85,752,800	120,030,000	71
Vocational training school	443 (17)	48,171,200	93,168,000	51.7
Music school	642	24,840,000	32,464,000	76



The kindergarten has the lowest percentage of normative transfers, and it will continue to decrease as the number of children declines (normative transfers are calculated on a per capita basis). Despite increasing (local) supplements, the institution has to reduce staff. That the institution operates at nine different sites increases costs.

The municipality has analyzed the financing of primary schools (see Appendix 5), which among other findings underlines the fact that costs are based on criteria often unreflected in the normatives. The most important conclusion of the analysis is that cost per pupils' group is highest in those schools where the number of pupils per group is the lowest (which normatives, based on number of pupils, do not reflect). The number and seniority of staff also affect cost but have no bearing on central transfers. On the other hand, municipal finances benefit through the provision of special activities; for instance, Petőfi primary school provides special education for mentally disabled children, for which the central normative transfer is twice as much as for normal education, while the costs are not significantly different.

In 1998, municipal expenditure for local secondary schools increased dramatically, primarily because in both secondary schools a drop in the number of pupils led to a decrease in central transfers (although the absolute normative amounts for various services have grown).

~~Analyses have proven that, although the absolute normative amounts for various services have grown, in both secondary schools a drop in the number of pupils led to a decrease in central transfers. A problem with the six-grade high school is that it is financed by the central budget as if it were a primary school.~~

It is this area where municipalities can feel the disadvantage of the current financing practices the most: even classes with very few pupils get financing. However, how long should a municipality contribute to the finances of such a costly education? (It has to be noted that this is not a mandatory service but undertaken voluntarily by the local government.) The ratio of operation costs and municipal revenues indicates that the local government should either drastically cut education costs (by merging institutions of groups of pupils and removing expensive education) or find alternative revenues.

— Other Services

As already shown, 45 percent of costs in this sector are covered from normative transfers (Table 4). This seems to be a high percentage relative to city management subsidies, which is due to the special support for the fire department.

The share of central support in the financing of the fire departments is 94 percent (HUF 69,479 thousand—in Table 4 this amount is included in the normative transfers), much greater



than in other services. It is worth looking at the financing of other services.

— Total required resources for other services	HUF 235,923
— Normative transfers for other services	106,661
— Of them central transfers for the fire department	69,479
— Remains	37,182
— Resources required for the fire department	73,540
— Required resources (without the fire department)	162,383
— Required own resources (PIT + normatives)	125,201 (77%)

The fire department excluded, in this sector (basically city management) 77 percent of operation costs have to be contributed.

In Püspökladány, operation costs of the Mayor's Office are in this sector; its financing demand, including costs of the City Council, amount to HUF 112,934 thousand, which is 70 percent of all financing, fire department excluded. This means that the city spends very little on the over 20 activities (culture and sports) also in this sector.

— **Local Revenues Policy**

As suggested in previous chapters, the service and institution financing system by itself, let alone renovation and investment needs urge the municipality to increase its local revenues. In this chapter the local revenue policy pursued by Püspökladány will be discussed, including its reasons for choosing among alternatives, the options it has, and the constraints it faces. In this chapter our focus will be on local taxes, fees and interest revenues. Asset management will be discussed separately.

Appendix 4 lists all municipal revenues. The most important ones are:

- C **Local revenues from operation:** primarily fees for meals and other fees. The nursery school, kindergarten, schools, the elderly center, the clinic and the culture hall as well as the library may collect fees.
- C **Finances taken from other institutions for operation:** the most important one is the transfer from the Social Security Fund for the Health Care Institution. Other transferred finances are related to the creation of community scheme jobs and vocational training contributions.

- C **Local taxes:** only business tax is collected; plot tax, introduced in 1992, was abolished December 31, 1997 by the City Council (the tax was a minimal sum anyway).
- C Further local revenues come from plot and property sales and from renting out agricultural land. The city has a plot and property sales plan.
- C Local revenues include **selling shares, dividends and interest revenues.**
- C **Rents** are paid by the two Ltds. in municipal ownership and tenants.
- C **Public area rents** and **environmental fines** represent minimal amounts in local revenues.

Table 10 summarizes Püspökladány's local revenues: Revenues resources in 1998 and 1997 (in HUF thousand):

Table 9
Revenue resources (HUF thousand)

Description	1997	1998	Change
Plot tax	3,000	—	-3,000
Business tax	32,000	43,500	+11,500
Sales of plots	3,000	6,500	+3500
Sales of property	3,600	34,600	+31,000
Interest revenue	12,000	9,000	-3,000
Sales of shares	71,000	5,600	-65,400
Total	124,000	99,200	-25,400
Borrowing	32,000	51,000	+19,000

From these figures the municipality drew the conclusion that revenue sources directly controlled by the municipality have decreased, which has led to their borrowing an additional HUF 19 million.

The list of revenues suggests that the municipality does not count on **fee revenues from citizens**. Although citizens pay for water provision and garbage removal, these fees feature in the budgets of the companies that provide these services. People, however, did



contribute to infrastructure investments in the city. The local government, when looking at alternative revenues, never includes fees. Besides relying on extra resources from cutting back on institutions, the municipality considers introducing a local tax.

C Local Tax Policy

The 1990 Act on local taxes authorizes local governments to introduce one or more types of local taxes, or none. Choices are heavily determined by the budget situation but also are a tool to shape a local tax policy (and local economy as well). Here the tax policy of Püspökladány is compared with that of five communities. Table 11 shows the various taxes levied by five municipalities ~~with~~; the year of introduction ~~in parentheses~~ are in brackets.

Table 10
Local taxes in the six cities

Nagykanizsa	Orosháza	Püspök- ladány	Szentes	Szolnok	Tatabánya
Building tax (1995)	Building tax (1992)	Plot tax (1992)		Building tax (1992)	Building tax (1995)
Business tax (1992)	Business tax (1995)	Business tax (1995)	Business tax (1993)	Business tax (1992)	Business tax (1993)
	Communal tax on entrepreneurs (1991)		Communal tax on citizens (1996)		Communal tax on entrepreneurs (1995)

Püspökladány introduced business tax relatively late compared to other communities. Though the city introduced plot tax as early as in 1992, revenues were so low that it was abolished in 1998. The strategy is not to overburden either citizens or businesses already paying very high central taxes. Nevertheless, it must be added that until 1995 introducing some larger volume local taxes did not seem necessary. The city relied on central transfers as long as it could and did not stretch the budget too much by engaging in large investments. In 1995, however, due to the budget situation, introducing the business tax became unavoidable. The city set the tax rate at 66.6 percent of the statutory ceiling (see table 13). Table 12 shows the per capita local tax revenue in the communities in our study. In comparison, tax revenues in Püspökladány are much lower than in Nagykanizsa, Szentes and Szolnok, which have similar tax rates. The explanation is most likely that the local tax capacity is very low.

Table 11
Local Tax Per Capita in Six Cities

Local Tax/Capita	1993	1994	1995	1996	1997
Nagyka nizsa	2,390	3,349	6,347	8,470	10,718
Orosháza	947	1,004	6,048	11,876	15,691
Püspökladány	176	153	1,056	2,340	2,295
Szentes	1,598	2,709	4,232	6,097	9,253
Szolnok	4,046	3,493	5,408	8,974	11,680
Tatabánya	2,235	2,680	2,814	3,913	5,434
Country Average	2,628	3,308	4,526	7,913	10,939
Country Average without Budapest	1,738	2,236	3,127	5,513	



Table 12
Business tax Rates in Six Cities (as Percent of Ceiling)

Business tax	1991	1992	1993	1994	1995	1996	1997	1998
Centrally defined ceiling tax rate	0.3	0.3	0.8	0.8	0.8	1.2	1.2	1.4
Nagykanizsa	—	66.6	75.0	100.0	100.0	66.6	83.3	100.0
Orosháza	—	—	—	—	100.0	100.0	100.0	85.7
Püspökladány	—	—	—	—	100.0	66.6	66.6	92.9
Szentes	—	—	75.0	75.0	75.0	66.6	100.0	78.6
Szolnok	—	33.3	100.0	100.0	100.0	66.6	66.6	92.9
Tatabánya	100.0	100.0	37.5	62.5	100.0	100.0	100.0	100.0

A serious obstacle to increasing local tax revenues is the lack of business capital. The paying ability of residents is also limited due to the high rate of unemployment (6.5 percent) and the fact that a large share of the population earns low wages. Despite this, it seems unavoidable to introduce some local tax at some stage, says the mayor. He also says that willingness to pay for infrastructure improvements is relatively high so people might be able to pay a moderate citizens' tax.

C **Asset Management**

Local governments are required to prepare their asset balance annually, at the same time as the annual final balance. Changes in the Püspökladány asset balance between 1992 and 1997 are presented in Appendix 6, showing that municipal assets nearly doubled from HUF 655,325 thousand to HUF 1,148,002 thousand, **counting for inflation**. The growth is due to the following factors:

- C Former state owned assets had been transferred to the municipality, as required by government decree XXXIII 1991. For instance, in 1993 the former Hajdú-Bihar county water company was one of the assets transferred for operation at a value of HUF 123,857 thousand.
- C Appreciation of physical assets is due to municipal improvements. In 1997 the value of municipal physical assets decreased by some HUF 100 million. At the same time the value of assets transferred for operation increased by approximately the same amount when the municipally owner Asset Management Ltd. was set up to provide utility services as a successor to City Management, a budget organization. The assets themselves, however, were not transferred to the ownership of the Ltd.



- C Until as late as 1996 financial investments grew. Financial investments included stock transferred to the municipality as required by the assets law already mentioned, as well as lending. Loans are the outstanding portions of sales prices of municipal rental housing to previous tenants. In 1997 TIGÁZ shares worth HUF 59 million were sold, which reduced municipal financial assets.

The volume of resources has changed in a similar way. The structure of resources: in 1992 the share of own capital in all assets was 82.1 percent, in 1997 87.3 percent. Long and short term liabilities decreased in this period from 2.5 percent to 1.18 percent.

As revenues from selling shares were used for investments, assets were not consumed.

C ***Deprived Region and Disadvantaged Community***

As is widely known, capital attraction is much lower in the eastern part of Hungary than in the West, yet this is not the sole reason why the Püspökladány region is regarded as underdeveloped. Other factors include the labor structure, infrastructure, and lack of highways. Hopefully, a government strategy designed to develop eastern Hungary will be able to ameliorate the situation. There is also the possibility that large multinational companies will gradually have to find space elsewhere than in western Hungary, which will bring about some change. Püspökladány is prepared: it has designated four areas for industrial development, though the legal category of industrial park is applied to any of them. Püspökladány offers investors:

- Serviced land
- Local tax exemption for a specified period of time
- Ensured health care
- Vocational training ensured by the local government
- Help in recruiting work force
- Financial support for employing unemployed from the region

As already discussed, the city itself is not rich; it is in fact the poorest of the communities in our study. As an underdeveloped region, it is eligible for a range of central grants. Yet it is not eligible for ÖNHIKI (support for municipalities in disadvantageous position not due to own fault). ÖNHIKI was designed to support municipalities that have no own resources to match central transfers to cover operational costs. This system, however, distorts

municipal behavior: local governments are sometimes able to categorize revenues in such a way that creates a revenue-expenditure structure making them eligible for the ÖNHIKI support. In this way, municipalities in much better financial condition than Püspökladány have managed to obtain this grant (Appendix 7 presents the set of eligibility criteria). The problem is not that Püspökladány does not get the ÖNHIKI support; in view of the expenditure items disregarded by the ÖNHIKI rules, it is easy to understand that several municipalities need this support even more than Püspökladány. The real distortion comes when complying with the eligibility criteria for the ÖNHIKI support becomes a strategy and, for instance, municipalities design their borrowing policy accordingly.

– Innovations in Financial Management

As early as 1995, it was clear to the local government that the previous financial management policy needed to be changed. As with so many other municipalities, Püspökladány decided to reform its financing when operations became seriously endangered. The most important reform measures are the Small Treasury introduced in 1997 as well as program budgeting in education and the communal sector introduced in 1998. Further plans for rationalizing finances have already been formulated.

– The Small Treasury

Since early 1997, financing of municipal institutions in Püspökladány has been ensured through a small treasury operated by the Mayor's Office.

Püspökladány's accounts are kept by OTP. Because the local government thinks that OTP has the greatest experience in this field, it has never thought of changing banks. The city received several offers from banks now competing in the local government sector, of which the best came from UNIC bank. However, the bank has no branch in the city so cooperation seems impossible. The Small Treasury was set up in cooperation with OTP.

Basically, in this system institutions receive only the exact sum needed for their daily operations. **A new account was created by the Mayor's Office to cover the expenditures of all institutions. Rather than transfer the full budget document for all expenditures at the beginning of the year, expenditure requirements are only transferred when needed.** The system works in the following way:

- c The institution submits to OTP a transfer request to cover a given supplier's bill. OTP draws the amount from the Mayor's Office account, enters it to the credit of the institution's account and simultaneously pays the bills. All this happens within one day.



- c Of course OTP does not have unlimited authority to make transfers between the Mayor's Office and institutions. The amount available for institutions (one twelfth of the annual budget estimate every month) is set by the municipal annual budget decree. The head of the institution is responsible for not spending more than the monthly amount. The Mayor may authorize the institution to draw an extra amount up to 10 percent.

The system was launched in the following way:

- C On behalf of the local government, the Mayor signed an agreement with institution heads, whereby the institution heads authorized OTP, as the bank keeping the institutional accounts, to give full information about the institution's cash flow to the Mayor's Office. The **new** contract between the Mayor's Office and OTP ~~was modified: the Mayor's Office~~ authorized OTP to transfer the requested amounts from the budget account to the institutions' accounts. The Mayor's Office may limit this authorization on an occasional basis in a written document.
- C The advantage of the system is that municipal financial resources are concentrated at one place and thus the city can draw greater interest revenues as the deposit is larger. The municipality may deposit resources for 7 days to collect greater deposit interest revenues.
- C Time requirement for transfers has substantially decreased.
- C Although the system has broken down several times, staff in the Mayor's Office regard the new system as worthwhile.

C **Program Budgeting**

The analysis and planning of education services and three city management services from a new perspective was elaborated in 1997 and adopted in the 1998 budget.

The annual tasks, natural indices and costs of park maintenance, public sanitation, and road maintenance have been processed with the tools of program budgeting. Through a programmatic view on services, interested parties, such as the City Council or citizens, may get much more information on the current state of these areas, on what has to be done and what improvements are necessary.

Education, as a crucial sector in the city, is presented in a more detailed way than in former years. Though the municipality currently does not apply performance measures either in education or in the three areas of city management, natural indices and accounting data provided by institutions help compare institutions and present the differences in efficiency, the possibilities of rationalizing operations, as well as the real reasons behind financing requests.

C **Further Plans to Rationalize**

As in other cities, in Püspökladány the greatest challenge is to make planning and use



of finances more transparent. Besides financial and economic considerations, political ones underlie all local government action, especially rationalizing measures; this sometimes impairs efficiency.

According to the head of the finance department, rationalizing institutions in the city would be very important. There are too many finance units, which is very expensive and inefficient. It would be more reasonable for all institutions to operate as a single finance unit. This would make the leadership structure simpler (there would not be as many directors, financial managers or deputy directors as institutions) and purchasing, financial management and maintenance would be done in a coordinated way. Despite the economic rationale, the finance manager does not think it politically feasible **in the near future due to the strength and independence of the institutions** ~~any time soon~~.

C CONCLUSION: CONSTRAINTS OF MUNICIPAL FINANCIAL MANAGEMENT

In this section factors that make financial management difficult in Püspökladány will be discussed. There are four major groups of factors: central regulations, limited local resources, unfavorable demographic trends and constraints related to the staff in the Mayor's Office.

The central government has much greater resources than services to be provided. More and more services are delegated to the local level but there is no coordination between sectoral (professional) and financial regulations concerning service provision. Too many pieces of legislation make orientation very hard.

In comparison to the other communities in our research, Püspökladány has the smallest maneuvering room: on the one hand because of its size (presumably, the larger a community is the more flexibility it enjoys) and on the other hand because of its economy (both the region and the city itself are the poorest ones in our research). Nevertheless, the problem is aggravated by the leadership strategy, which delays introducing local taxes, does not make large investments and relies too heavily on central resources.

Annual changes in the size of transfers make long term planning very hard; in addition, the fact that certain subsidies (centralized items) are transferred only after a set of criteria are met significantly distorts annual budgets (and makes proper budget planning impossible).

In this case study scarcity of local revenue resources have been discussed at length. Despite the fact that, in our view, both citizens' and businesses' tax paying capacity is under-



exploited, it would be very difficult to support new businesses (relief and exemptions in business tax) and collect greater taxes from them at the same time.

The current normative transfer system is not favorable for the city in its current demographic environment. The local government faces substantial operational difficulties on account of the decreasing number of pupils, constant number of staff and relatively high permanent costs in education.

Staff represents some kind of problem in all municipalities. There can be too few staff in a group or department, or their qualifications are not adequate; in some cases the necessary professional is missing altogether (for instance the local government cannot afford to hire an economic analyst).

C

CAPPENDICES

C APPENDIX 1

Mandatory services in Püspökladány

SERVICE	PROVIDER
Healthy drinking water	Municipally owned Ltd.
Kindergarten education	Municipal institution
Primary school education	Municipal institution
Primary health and welfare care Physician Emergency health care Mother, baby and child protection (district nurse) Dentist Financial and in-kind support for the needy	Family doctors as private business and municipal institutions
Street lighting	Share holder company
Maintaining local roads and cemetery	Municipally owned Ltd.
Ensuring the rights of national and ethnic minorities	Minority council. ethnic education in kindergartens and primary schools.

C Non-mandatory municipal services

Services related to city management

SERVICE	PROVIDER
Public area surveillance	Municipal organization
Community scheme employment	Municipal organization
Operating welfare facilities	Municipal organization
Geodesy	Municipal organization
Water ducting	Municipal organization
Administration of cattle	Municipal organization
Park maintenance	Municipally owned Ltd.
Baths	Municipally owned Ltd.
Municipal rental housing management	Municipally owned Ltd.
Management of non residential units	Municipally owned Ltd.
Operating the dog pound	Municipally owned Ltd.
Public cleanliness	Municipally owned Ltd.
Operating the land fill	Municipally owned Ltd.
Market and cattle market management	Municipally owned Ltd.

C Social services

SERVICE	PROVIDER
Nursery school	Municipal organization
Social meals	Municipal organization
Home assistance	Municipal organization
Day care	Municipal organization
Out patient health care	Municipal organization
Family center	Municipal organization

C Education

SERVICE	PROVIDER
Secondary education	Municipal organization
vocational training	Municipal organization
high school education	
vocational secondary education	
technical education	
Primary musical education	Municipal organization
Primary arts education	Municipal organization

C Other sectors

SERVICE	PROVIDER
Public non-school education	Municipal organization
Sports	Foundation
Support associations' activities	Associations
Operating the mayor's office	Municipal organization
Library	Municipal organization
Summer camp for the youth	Municipal organization
Sports hall operations	Municipal organization
Support for the local newspaper	Municipal organization
Support for civil defense activities	Municipal organization
Support for the Enterprise Development Foundation and the Education Advice Center	Foundations
Maintaining the sports field	Municipally owned Ltd.
Maintaining the museum	Municipal organization
Fire department	Municipal organization
Support for churches	Church